

## **QUESTIONS AND ANSWERS ON THE NEW LENDER AND LENDER SERVICER AUDIT GUIDE**

Note: It is our intent to periodically update this document with new questions and answers. Questions should be faxed to the Non-Federal Audit Team at 202-205-8238 or e:mailed to Theresa.Lehr@ED.Gov.

### **Questions and Answers as of March 12, 1997**

#### **What is the effective date of the new guide for lenders?**

The new guide, *Compliance Audits (Attestation Engagements) for Lenders and Lender Servicers Participating in the Federal Family Education Loan Program*, supersedes the March 1995 lender audit guide and is effective for lender audits of fiscal years ending on or after December 31, 1996.

#### **What is the effective date of the new guide for servicers?**

Application of the new guide is effective immediately for servicer audits.

#### **What fiscal year are the initial audits due for a servicer?**

The implementing regulation (34 CFR 682.416) requires annual servicer compliance audits beginning with the servicer's first full fiscal year that began on or after July 1, 1994. Servicers with fiscal years ending June 30 through October 31 have the option of having an annual audit for fiscal years 1995 and 1996 or a combined audit for the two years. The initial audits for servicers with fiscal years ending November 1 through December 31 are required for their fiscal year 1995. The initial audits for servicers with fiscal years ending January 1 through June 29 are required for their fiscal year 1996.

#### **What is the submission due date of the servicer's initial audits?**

The initial compliance audit report for all servicers is May 31, 1997.

#### **What is the submission due date of subsequent servicer audits?**

Subsequent annual servicer audits are required to be completed and submitted to ED within six months after the close of the servicer's fiscal year.

#### **What conditions must be met for servicers to be able to submit to ED the audits previously performed of a servicer's fiscal years 1995 or 1996 in support of the lender audit requirement?**

Servicers may submit to ED only those audits that they previously had performed and provided to their lender clients in support of the lender's audit requirement provided all of the following conditions are met:

- a. The servicer's fiscal year audited ended prior to or on October 31, 1996.
- b. The audit was performed by an independent practitioner.

- c. The audit was performed in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States; standards established by the American Institute of Certified Public Accountants; and the March 1995 Lender Audit Guide, *Compliance Audits (Attestation Engagements) of the Federal Family Education Loan Program at Participating Lenders* issued by the U.S. Department of Education, Office of Inspector General, and
- d. The audit addressed all applicable compliance requirements and applicable assertions contained in Section II of the March 1995 lender audit guide.

**What is the requirement for a servicer whose prior audit does not meet all of the conditions?**

Servicers whose prior audits do not meet all of the required conditions must have the audits reperformed for those fiscal years in accordance with the new lender/lender servicer guide.

**What guide should servicers with fiscal years ending on or before October 31, 1996 and who did not previously perform audits of their fiscal years 1995 or 1996 use?**

Servicers with fiscal years ending on or before October 31, 1996 who did not previously perform audits of their fiscal years 1995 and 1996 in support of the lender audit requirement are required to use the new lender/lender servicer guide issued in December 1996.

**What should be included in the reporting package of servicers who want to submit to ED the audits they previously had performed of their fiscal years 1995 or 1996?**

The reporting package should comprise the same elements as those in the standard lender engagement described in Section IV of the March 1995 lender audit guide. The reporting package should include:

- a. The independent accountant's report containing an opinion on the servicer management's assertions about compliance with the specified compliance requirements identified in Section II of the March 1995 Lender audit guide that pertain to the functions carried out by the servicer or direct opinion on compliance and any findings.
- b. If applicable, a copy of any written communication to the servicer's management of any reportable conditions or material weaknesses noted.
- c. If not disclosed in the report, any separate communication disclosing the impact of any findings on a lender's portfolio.

In addition, servicer managements should attach to the reporting package the information sheet illustrated on Appendix B, Example 1 of the December 1996 Lender/Lender Servicer audit guide.

NOTE - Technical Amendment: If a separate report on illegal acts was written by the practitioner, that report should be sent directly to the ED Office of Inspector General, Investigations Services and NOT be included as part of the reporting package submitted to ED Guarantor and Lender Oversight Staff.

**If a servicer with a fiscal year ended June 30, 1996 issued and provided its fiscal year 1996 report to its lender clients prior to issuance of the new guide, does the lender have to request the servicer to produce additional reports to cover the three new assertions included in the new audit guide for its lender clients that have a fiscal year end December 31, 1996?**

No. ED has determined that any lender who utilized a servicer with a fiscal year ending between 6/30/96 and 10/31/96 does not have to ask those servicers or have the lender's practitioner go to those servicers to cover the new due diligence assertions contained in Section II of the new audit guide (compliance requirements 10, 11, and 12).

However, any lender who performs the due diligence functions themselves or utilizes a servicer(s) with a fiscal year ended before June 30, 1996 or on or after November 1, 1996 will have to include the new due diligence assertions in its report. (Note: Servicer reports prior to 6/30/96 could not be used by a lender with a fiscal year-end of 12/31/96 because those reports do not end within 6 months of the lender's reporting period.)

If a servicer's fiscal year-end falls anywhere between June 30, 1996 to October 31, 1996, the servicer may wish to voluntarily opt for earlier application of the new audit guide requirements and have their independent practitioner include tests of due diligence in their audit so that the report can be utilized by the affected lender clients.

**I am a lender with a fiscal year ended 12/31/96. Our portfolio reached \$5 million in December of 1996. For what fiscal year are we subject to the audit requirement and what should be covered?**

A lender who held and/or originated more than \$5 million FFEL program loans during any audit period must have an audit conducted in accordance with the ED/OIG audit guide. ED applies the \$5 million threshold to any audit period in which the lender held and/or originated loans rather than the lender's fiscal year end because the ED Form 799s are required to be submitted to ED after the end of each quarter. As a result, the period of loan activity covered by the attestation engagement-- that is, loan activity reported in ED Form 799s *submitted* during the lender's fiscal year--is not the same as the lender's full fiscal year activity.

Therefore, you would be subject to the audit requirement for your fiscal year ended 12/31/97. That audit would cover all the ED Form 799s that are submitted during that fiscal year, i.e., those for the quarters ending 12/31/96, 3/31/97, 6/30/97 and 9/30/97. If additional 799s are submitted to ED during that fiscal year (to report additional adjustments, etc.) those would also be covered by the audit. To ensure consistent reporting, the period of loan activity tested under compliance requirements 10, 11, and 12 in the audit guide concerning collections, claims and cures (due diligence) should be aligned with the testing of the 799s submitted during the lender's fiscal year.

**Can an auditor of a secondary market, which is a nonprofit corporation, rely upon the work of the practitioner engaged to perform the lender's third-party servicer audit?**

Lenders that are nonprofit organizations have the option of obtaining an audit in accordance with OMB Circular A-133 or the lender audit guide. We understand that your client is a secondary market and chooses to have an audit performed in accordance with Circular A-133.

When performing that audit it is highly recommended that you consult the lender audit guide as it identifies the compliance requirements that should be tested for that audit.

When performing the audit in accordance with Circular A-133 for your lender client, you may rely upon the work of the practitioners engaged to perform the audit of the lender's third-party servicer. You should follow applicable standards governing the reliance and use of another auditor's work and reports and any guidance contained in Section III of the lender audit guide that may be applicable. This includes performing procedures to ensure yourself that all programmatic compliance requirements were tested and addressed in the third-party servicer's audit(attestation) report. See also paragraph §.210(f) "Compliance responsibility for vendors" of OMB Circular A-133. Question 58 of *Questions and Answers on OMB Circular A-133*, published by the President's Council on Integrity and Efficiency in May 1992 may also be helpful.

### **What is the practitioner's responsibility for detecting illegal acts?**

Practitioners are required to design and perform procedures to provide reasonable assurance of detecting significant illegal acts. The procedures performed by practitioners showing they met this requirement should be evident in the working papers.

### **Should the practitioner's report on illegal acts be submitted as part of the reporting package to ED/GLOS?**

No. If a separate report on illegal acts was written by the practitioner, that report should be sent directly to the ED Office of Inspector General, Investigations Services at the address provided in the guide. The report should NOT be included as part of the reporting package submitted to the ED Guarantor and Lender Oversight Staff, as instructed on page IV-2 of the December 1996 audit guide. This is a technical amendment that will be incorporated in a future update to the guide.

### **If a lender (or servicer) management detects fraud ITSELF and reports it to ED (either program office or OIG/Investigations) is the IPA required to report the fraud again? (assuming the IPA has credible evidence that it actually was reported).**

The IPA is required to report fraud to OIG/Investigations regardless of when or where it previously was reported. If the IPA has evidence that it was previously reported, they need only send a copy of the previous notification to OIG/Investigations at the address provided in the guide.

### **If fraud was previously reported by the lender (or servicer) management and action has already been taken by ED is there any requirement for the IPA to report the fraud to OIG/Investigations?**

If the fraud was previously reported and action was taken by ED, again OIG/Investigations would want to know about it. The IPA need only send a copy of the original referral and what was determined to OIG/Investigations at the address provided in the guide.

**Our client is a servicer who will be providing the audit report to its lender clients. Should the sentence in the last paragraph on page B-4 of Appendix B, Example 3 be modified to include reference to those lender managements?**

Yes. If the intent is that the servicer will be providing the audit report to its lender clients so that it can be utilized by them in fulfillment of their own audit requirement, then the practitioner should modify that paragraph to state that the report is intended solely for the information of the audit committee, servicer management, specified lender clients, and the U.S. Department of Education.

**Should the assertion concerning timely claim filing by lenders or servicers be modified to include a reference to 34 CFR 682.402(g)**

Yes. Lender or servicer managements who perform this function and are responsible for making such an assertion should include a reference to 34 CFR 682.402(g) in their assertion. That citation specifically identifies the deadlines for filing bankruptcy claims with the guaranty agency. It was discussed under the compliance requirement section of the guide but accidentally omitted from the example assertion. This is a technical amendment that will be incorporated in a future update to the guide.

**Can a lender, servicer or practitioner designate any of the contents of the reporting package (information sheet, corrective action plan, practitioner's reports, internal control deficiencies, findings, and comments on prior audit resolution matters) as "confidential commercial information?"**

It is the Department's position that generally none of the contents of the reporting package is deemed confidential commercial information, especially the practitioner's reports which explicitly state that those reports are matter of public record and their distribution is not limited.

The reference to designating information as "confidential commercial activity" contained in the audit guide pertains to the practitioner's audit working papers that may be asked to be submitted to ED/OIG in connection with an investigation, audit, inspection or other inquiry pursuant to the Inspector General Act of 1978, as amended, 5 U.S.C. app. 3, sec. 1 et seq and not the reporting package that is submitted to ED.

However, if a lender or servicer strongly believes that portions of the reporting package contains confidential commercial information, the lender or servicer should make that determination in the transmittal letter sent to ED by clearly stating which sections it determines should remain confidential and the reasons thereof. ED however, reserves the right to make its own determination of whether a Freedom of Information Act (FOIA) requires disclosure or whether it should be withheld.

**How does the practitioner designate audit working papers as "confidential commercial activity?"**

Practitioners who deem any of the working paper information to be "confidential commercial information" can take appropriate steps to so designate that information. "Confidential commercial information" means records that may contain material exempt from release under Exemption 4 of the FOIA (pertaining to trade secrets and commercial or financial information

that is privileged or confidential) because disclosure could reasonably be expected to cause substantial competitive harm.

You may use any reasonable method you believe appropriate to indicate which documents and information you deem to fall into the category of “confidential commercial information.” You must be as specific as possible in segregating the information that you consider to be “confidential commercial information” from any other information you are providing to the OIG.

This may be done before such information is provided to the OIG if feasible, but only if it will not delay or interfere with production of the information or delay or interfere with the OIG's investigation, audit, inspection or other inquiry. Otherwise, you may so designate this information within a reasonable period of time after the information is provided to the OIG.

### **How can copies of the new guide be obtained?**

Copies of the new guide can be obtained by calling the Federal Student Aid Information Center (800) 433-3243 or electronically through the ED/OIG Non-Federal Audits Team Web Page at: <http://home.gvi.net/~edoig>.